Can't quit China

Sourcing diversification limited by lack of manufacturing, infrastructure elsewhere

By William B. Cassidy

US IMPORTERS TRYING to shift their sourcing of goods away from China are running into an obstacle as high as that country's Great Wall: China's massive manufacturing base and logistics infrastructure.

Since the rise of China as the world's low-cost manufacturing hub, shippers have sought to diversify their production and procurement for various reasons, be it inventory management, concerns over forced labor or geopolitical conflict, or simply to mitigate supply chain risk. Those efforts have been compounded in recent years by US government interventions aimed at stimulating domestic manufacturing,

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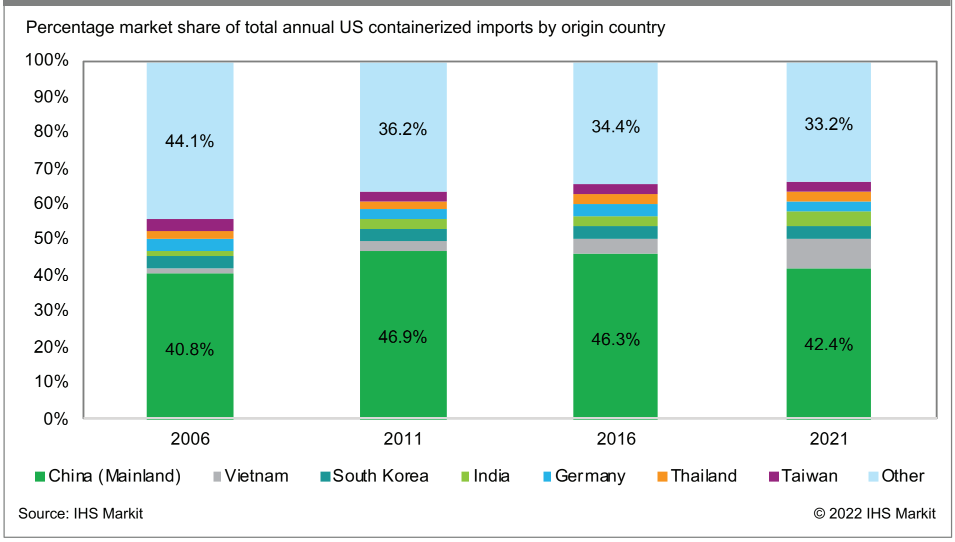
namely anti-dumping duties and higher import tariffs on certain Chinese-made goods.

And yet, containerized US imports from China hit a record high in 2021, rising 13.9 percent to 11.8 million TEU, with 42.4 percent of all imports sourced from China — the same percentage as in 2008 — according to PIERS, a sister product of *The Journal of Commerce* within IHS Markit. Despite shippers' previous attempts at diversification, China's share of total containerized imports peaked at 47 percent in 2018 after nine years of steady growth.

The continued growth in US imports from China suggests that when consumer goods demand surges, importers are willing to eat the cost of tariffs and higher ocean freight rates to bring more goods from China because they have no other viable option. It also suggests they have absorbed the cost of those tariffs, imposed by the Trump administration in 2018 and kept in place by the Biden administration.

China also has a considerable, though not-quite-as-commanding, lead when it comes to US exports.

China's US import share rebounded in 2021 despite diversification efforts



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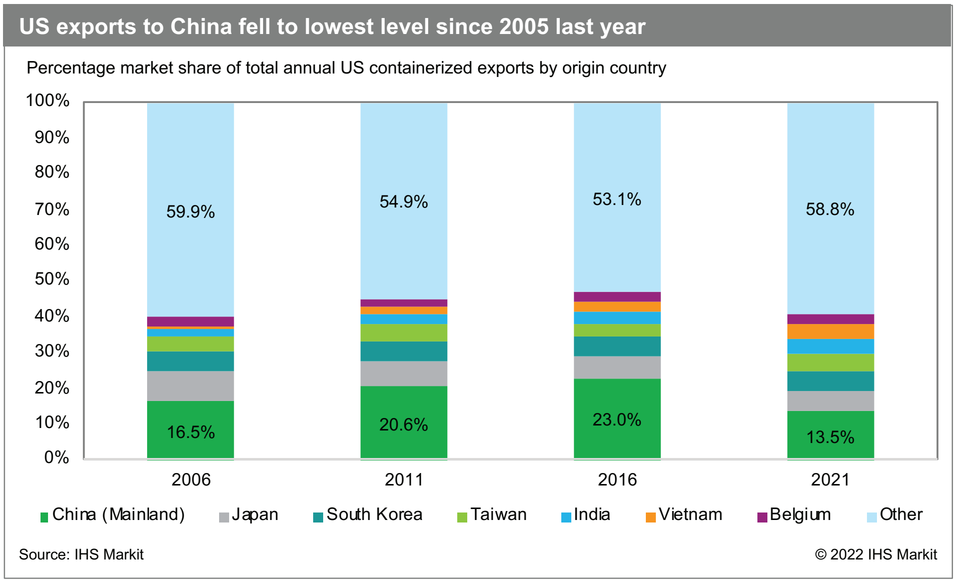
China accounts for 13.5 percent of containerized US exports, followed by Japan (5.8 percent), South Korea (5.5 percent), and Taiwan (5 percent), despite shipments to China falling in four of the last five years, including a 20 percent year-over-year slide in 2021.

After first surpassing 2 million TEU in 2009 and peaking at 3 million TEU in 2013, US exports to China dropped to 1.6 million TEU last year, a 26.2 percent decrease since the escalating tit-for-tat tariff battle between the US and China began in 2018.



Only three of the top 10 US export markets overseas grew on a year-over-year basis in 2021: India (20.7 percent), Thailand (19 percent), and Belgium (5.2 percent), a gateway to Europe and the only country outside of Asia among the top 10 export markets. Excluding China, exports to those top 10 countries have fallen 4.1 percent since 2018.

Easier said than done

The data confirms that the trade imbalance between the US and China is deepening and underscores the difficulty of translating shipper rhetoric about "reshoring" and "nearshoring" into reality. The US–China trade war wiped out 10 years of import share gain, but China still produces far more US consumer goods than any other country.

Neighboring countries in Asia, primarily Vietnam and India, have been the main beneficiaries of China's declining market share. Vietnam's share of US imports rose to 8.2 percent last year from 4.8 percent in 2018, while India's share increased to 3.8 percent from 3.1 percent at the start of the trade war.

Vietnam's share of US imports rose to 8.2 percent last year, but China's 42.4 percent share of 2021 US imports in 2021 still dwarfs that of any other country.
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However, two years of consecutive growth in annual US import volumes from China since the start of the COVID-19 pandemic also demonstrates how difficult it will be for importers to truly decouple from China's massive manufacturing complex.

That's important not just to US businesses dealing with supply shortages and the higher cost of transporting goods into the country but to the wider public debate over trade and political relations with China. Both major political parties are calling for reinvestment in US manufacturing ahead of the 2022 midterm elections, and Congress is already considering a broad competition bill that would reduce US corporate reliance on Chinese companies.

"There's definitely a long-term goal to continue to move more production out of China and into countries like Brazil and Mexico," Ed Rosenfeld, CEO of apparel company Steve Madden, said in an earnings call April 27. The company has drawn down the amount of goods and materials it sources from China in recent years, but moving sourcing and production to new sites across the globe is complex — and expensive.

That's because no country other than China has the capability to meet American consumers' unquenchable demand for containerized imports, a point recognized by consulting firm Kearney in its 2021 Reshoring Index report, released in April. Kearney tracks US imports from 14 Asian nations to create a manufacturing-import ratio that shows imports as a percentage of US gross domestic manufacturing output.

The index dropped into negative territory for the second straight year in 2021 after initially rising following the imposition of US tariffs on a broad range of Chinese goods, indicating greater reliance on imports from Asia. In its index report, Kearney said US importers "are looking at each other to see if there will be enough critical mass in the reshoring movement to build a critical ecosystem that can rival what China has built."

Rather than a mass exodus, gradual shifts in sourcing are more likely as China's own policies throttle back its economic expansion and fractured geopolitical relationships in the wake of the ongoing Russia–Ukraine war reshape international trade.

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'Best' vs 'lowest'

Exporters increasingly will look not only to China's competitors in Asia when diversifying sourcing of goods and raw materials, but to markets closer to their end consumers, wherever they may be, said Patrick Newport, executive director of US economics at IHS Markit, now part of S&P Global.

That won't necessarily translate to simpler or more direct supply lines to US businesses and consumers, however. "Complicated supply chains are here to stay, because pressure to produce in low-cost countries will continue," Newport said at the JOC Breakbulk and Project Cargo conference in New Orleans April 26. China may no longer be the country with the lowest manufacturing costs, but other low-cost countries simply can't replicate its volumes, he said.

According to Kearney, US-based companies are relying more heavily than ever on manufacturing operations in low-cost countries in Asia.

As a result, combined volumes from Vietnam, South Korea, and India, the next three largest sources of US imports have soared 59.8 percent since 2018, vastly outpacing China (3.6 percent) and the overall market (15 percent). But despite that growth, which includes a 20.1 percent year-over-year jump in 2021, US imports from those countries still totaled just 4.4 million TEU last year, compared with 11.8 million TEU from China.

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A survey of US manufacturing executives that accompanied the 2021 Reshoring Index report found growing support for reshoring, despite the drop in the index, but Kearney said the question of whether — and where — to reshore is becoming "more nuanced" after two years of supply chain disruption tied to the COVID-19 pandemic and subsequent flood of US import demand.

More companies are pursuing "the best cost, instead of the lowest cost," Kearney said, weighing manufacturing and transportation costs against factors like supply chain resiliency and environmental sustainability.

Thanks to that much larger baseline of volume, China's market share of US imports still grew 0.4 percentage points last year, slightly faster than Vietnam's (0.3 percentage points) and South Korea's (0.1 percentage points). Only India grew its share faster than China last year, as a 32.4 percent jump in volume brought the country's slice of the US sourcing pie up 0.6 percentage points to 3.8 percent.

On the other hand, that six of the top 10 countries supplying US imports increased their volumes by double-digit percentages in 2021, compared to just two countries in 2019 and 2020, is a sign that some attempts at diversification have been successful.

Mexico — long hailed as one of the primary beneficiaries of reshoring or nearshoring — increased the number of trucks it sent into the US by 13.7 percent to 6.9 billion trucks in 2021, according to US Bureau of Transportation Statistics data. Most of Mexico's US-bound exports travel in 53-foot truck trailers or intermodal rail containers, rather than international containers. That makes a direct comparison with other nation's containerized volume difficult, but investment in production capacity in Mexico is rising.

Diversification can be a double-edged sword. Companies that shifted production to Vietnam were stung last year by widespread factory closures caused by COVID-19 lockdowns. Furniture maker Hooker Furnishings, for example, which sources about 75 percent of its imported products from Vietnam, suffered a 13 percent decline in consolidated sales in its last quarter because of those lockdowns.

"Vietnam is obviously a major part of our sourcing," Hooker CEO Jeremy Hoff said in an April 13 earnings call with Wall Street analysts. "Malaysia is probably second, then you get into China, Mexico, India, we even have some Portugal." The furniture maker said it is continually rethinking its sourcing and logistics strategies as global events, including Russia's illegal invasion of Ukraine, alter supply lines.

Volatility is also driving importers toward sourcing products from multiple markets to avoid stockouts. "We are further diversifying the geographic footprint of our global sourcing across China, Southeast Asia, and Mexico and creating more dual sourcing to improve cost and certainty of supply," Julien R. Mininberg, CEO of consumer products company Helen of Troy, said during an April 27 earnings call.

That diversification and "dual sourcing" leads to shorter lead times, lower inventories, and reduced exposure to global geopolitical friction and tariffs, Mininberg said. JOC

email: bill.cassidy@ihsmarkit.com
twitter: @willbcassidy